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Sheer Energy Inc.

2001 Annual Report

Corporate Profile

Sheer Energy Inc. is a publicly traded oil and gas exploration and production company. Approximately 79% of the Company's revenues are generated from gas production with one-half of all gas revenue being derived from an interest in the South Edson Gas Unit.

Subsequent to the fiscal year end, the Company announced that its wholly owned subsidiary, Sheer Energy (Cyprus) Limited, had received all necessary approvals for its Service Contract for the development of the Masjed-I-Suleyman oil field in Iran. Sheer Energy (Cyprus) Limited is the Operator of the project and holds a 49% working interest therein.

Financial Summary

Year Ended December 31	2001	2000
Total revenue (net of royalties)	\$ 762,244	\$ 788,706
EBITDA	368,288	514,812
Cash flow from operations	254,695	353,049
Cash flow from operations per share (basic & fully diluted)	\$ 0.05	\$ 0.07
Earnings	80,937	166,112
Earnings per share (basic & fully diluted)	\$ 0.02	\$ 0.03
Capital expenditures	350,302	628,839
Total assets	\$ 1,685,594	\$ 1,713,854
Common shares O/S (Dec. 31)	4,837,863	4,837,863

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Annual Meeting

The Annual General Meeting of the Shareholders of Sheer Energy Inc. is to be held at 3:30 p.m., on Thursday June 13, 2002 in Salon "A" of the Delta Bow Valley Hotel, 209 – 4th Avenue S.E. Calgary, Alberta.

Cover Photo

Kuh-E-Shah Structure, one of the several large anticlines in the Zagros Mountains fold belt.

Photo by Dario Sodero



President's Message

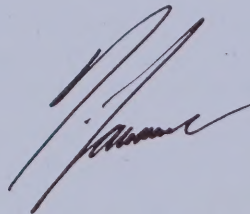
Without a doubt, the most important corporate development since our last annual report was the February 12th, 2002 announcement by our wholly owned subsidiary, Sheer Energy (Cyprus) Limited, that all necessary approvals for the Masjed-I-Suleyman (MIS) project in Iran had been received. This milestone certainly took much longer to reach than first anticipated but we now expect the project to proceed in accordance with our timetable which has been adjusted to account for the delays. We have already awarded the contract for the comprehensive reservoir study and simulation to Exploration Consultants Ltd. (ECL), a geological and petroleum engineering consulting company with offices in Calgary, London and Tehran. They will be assisted by Paravar Engineering of Tehran and data gathering and acquisition is expected to commence in early May. This study will be crucial to the project as through the study we will identify existing wells for recompletion as well as drilling locations for the proposed vertical and horizontal wells. As well, the Company has already hosted a delegation of Iranian technical personnel from both the National Iranian Oil Company and the Budget and Planning Organization on a technical exchange to demonstrate both the modern technologies and the type of facilities which will be employed in the MIS project development. A full discussion of the MIS project is included elsewhere in this report.

This is an exciting opportunity to apply modern practices and technologies to achieve enhanced recoveries from a very substantial reservoir. Success at MIS may well open up additional opportunities to the Company within the project area. Success will also have significant implications for a number of other similar reservoirs in Iran.

On the domestic front, 2001 was a year of both highs and lows in terms of product pricing with the latter predominating. Unusually high natural gas prices early in the year deteriorated with the onset of Spring and continued their downward slide throughout the balance of the year. Early strong results started to fade with each ensuing quarter with the result that earnings for the year were \$80,937 (\$0.02 per share basic and fully diluted) compared to \$166,112 (\$0.03 per share basic and fully diluted) in the 2000 fiscal year. On a positive note, recent natural gas prices have risen toward the end of the current winter heating season and oil prices have recovered, at least temporarily. Cash flow from operations for the year was likewise impacted by pricing as well as increased royalty and operating costs with the result that it decreased from \$353,049 in fiscal 2000 (\$0.07 per share basic and fully diluted) to \$254,695 (\$0.05 per share) in fiscal 2001. Production through the year was relatively consistent with that of the preceding year at about 79 BOE/d. A small decrease is expected in the 2002 fiscal year as a result of the sale of the Pine Creek Unit interests effective January 1, 2002. This relatively minor property was sold to an oil and gas trust for \$165,000, which was deemed to be a very good price based upon our most recent evaluation.

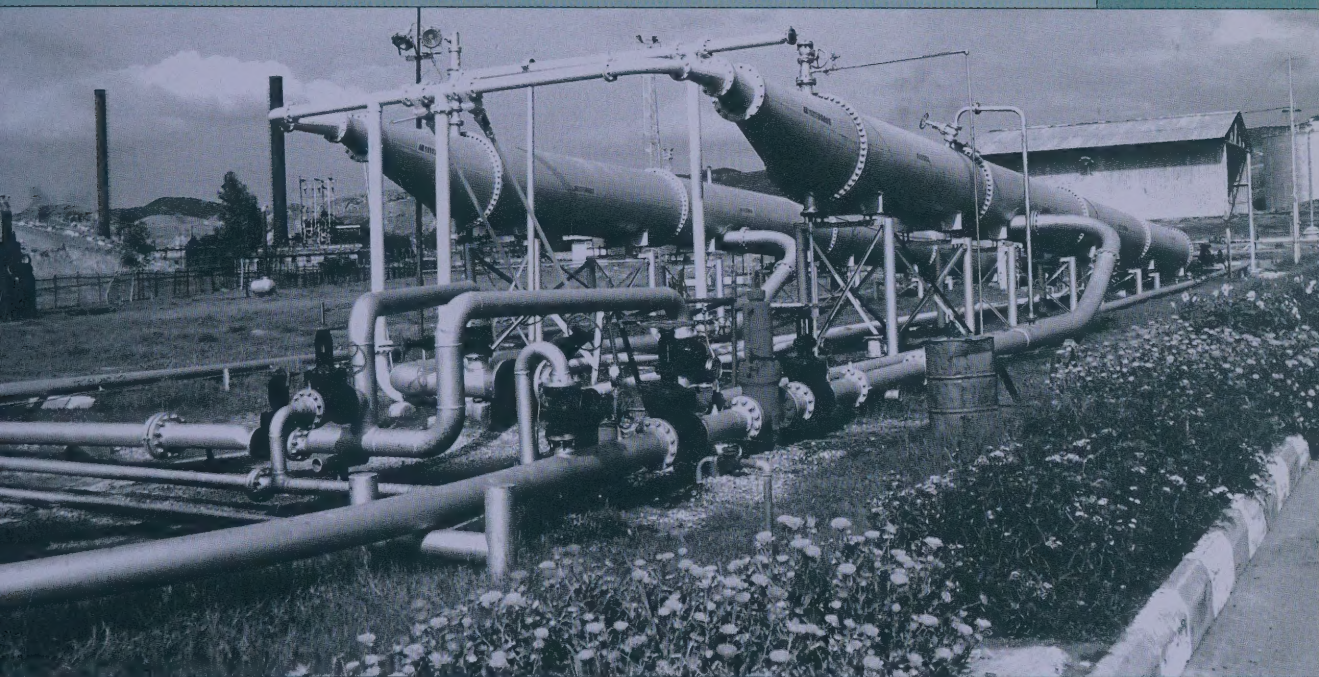
The outlook for the next year is very positive. Funding for the first 12 to 18 months of the MIS development will be undertaken from existing credit lines, future cash flow and either debt or equity financing. We are presently awaiting receipt of a proposal from overseas interests. We feel that with the first stage of the project completed, that being the comprehensive reservoir study, and the successful recompletion of four to six wells, we will be in a much better position to obtain financing for our 49% share of the balance of the project costs.

We would like, once again, to thank the shareholders for their support and patience and the members of the Board of Directors for their dedication and wise counsel.



May 3, 2002
Calgary, Alberta

T. D. Lawrence
President



The Masjed-I-Suleyman Field, Iran

HISTORY OF THE FIELD

Crude oil was first struck at Masjed-I-Suleyman (MIS), in the province of Khuzestan, Iran, on May 26, 1908. This was the first commercial discovery in the Middle East and established the Anglo-Persian Oil Company, later renamed British Petroleum, as a major international oil company.

Construction of a pipeline from MIS to Abadan, some 210 kilometers over rugged and inhospitable terrain, was completed in 1911 and oil production commenced in March 1912.

The MIS field is a large anticlinal structure, approximately 30 kilometers long and seven kilometers wide at the mid-section. The field has an areal extent of approximately 117 square kilometers and is adjacent to the town of Masjed-I-Suleyman, in the Zagros Mountains fold belt, 170 kilometers from the northern end of the Persian Gulf.

Production is derived from the Asmari carbonates of upper Oligocene and lower Miocene age.

The Asmari formation consists of fractured limestones and minor dolomites, with low matrix porosity and permeability, but very high fracture porosity and permeability. The stratigraphic thickness of the reservoir is approximately 323 meters (1,060 feet). Depth to the producing formation ranges from 195 meters (640 feet) at the crest of the structure to 1,100 meters (3,600 feet) on the flanks.

The Asmari formation is overlain by the Lower Fars formation of Miocene age which acts as the seal for the oil reservoir.

Based on information available through literature and initial data provided by the National Iranian Oil Company (NIOC), Sheer has estimated that the MIS reservoir probably contained between 5.0 and 6.5 billion barrels of original oil in place. These values are corroborated by volumetric analysis as well as material balance calculations performed by an independent engineering consulting firm. Total cumulative oil production to date is approximately 1.121 billion barrels. The quality of Asmari crude is excellent, at 40–42 API.

As a term of comparison, the largest oil field in western Canada (the Pembina Cardium oil field), discovered in 1953, contained estimated reserves of 7.8 billion barrels of original oil in place and has produced 1.201 billion barrels from a total surface area of 2,542 square kilometers which is approximately 22 times larger than MIS. It is also worth noting that the total number of producing wells in the Pembina Cardium field is just shy of 5,500 wells, while the total number of wells producing at any one time at MIS never exceeded 24. The total number of wells drilled to the Asmari over the years is approximately 270.

The MIS field's production peaked at over 132,000 bopd in the mid 1930's, with average production per well of 5,500 barrels per day. During the 1950's and early 1960's, total field production averaged 45,000 bopd. The primary recovery mechanism for MIS and similar large Asmari fields is gas cap expansion while natural water drive is of secondary importance.

The production facilities in the field allowed handling of only limited amounts of water and, due to specifications for crude oil delivered to the Abadan refinery, several dozens wells were suspended when they reached a threshold of 4% water cut, which is extremely low by Canadian standards.

In late 1963, NIOC drilled an exploratory well on the crest of the MIS anticline targeting the deeper Jurassic horizon at approximately 3,000 meters. Unfortunately this resulted in a gas blowout at surface, which destroyed the drilling rig, and an internal blowout which moved more than 90 billion cubic feet of Jurassic gas into the Asmari formation and increased the Asmari reservoir pressure by over 100 psi. It is reported that up to 0.5 trillion cubic feet of sour gas was vented and burned as relief drilling operations were being conducted and finally completed in 1967.

Several Asmari wells were shut-in during this period and production declined to 20,000 bopd.

In addition, during the eight year war between Iran and Iraq in the 1980's, the MIS field was completely shut-in. As a consequence of these events, there has been no development drilling in the field since the 1960's and only a few wells have been placed back on production in the last fifteen years.

The field is currently producing approximately 4,500–5,000 bopd from six or seven wells. All wells are flowing naturally or use a simple gas-lift system to aid in the recovery of oil since in Iran conventional pump-jacks are not in use. The remaining net oil column in the field ranges from 65–87 meters (215–285 feet) on the south flank of the anticline to almost 150 meters (500 feet) along the more sparsely drilled north flank. Similarly, there is a difference in reservoir pressure between the south and north flank of the structure, with the south flank being in the 430–450 psi range and the north flank in the 566–600 psi range. Initial reservoir pressure at the time of discovery was 1,078 psi.

PROPOSED RE-DEVELOPMENT PROGRAM

Sheer Energy (Cyprus) Limited and its Iranian partner, Naftgaran Engineering Services Company (NESCO) approached the National Iranian Oil Company in early 1999 with a proposal to re-develop the MIS field and increase the production by an incremental 20,000 bopd through the re-completion of existing shut-in wells, drilling of vertical and horizontal wells, installation of production and water handling facilities and the use of high-lift pumps.

All the necessary approvals for the MIS project were obtained on February 12, 2002 and all the terms of the Service Contract with NIOC were finalized in March 2002. The term of the Service Contract is for seven years, consisting of four years of development and three years of production.

The Company and NESCO, are proceeding with the following development plan and time schedule:

◆ Comprehensive geological/engineering study and reservoir simulation	2002/2003
◆ Re-completion of 4-6 selected non-producing wells	2002/2003
◆ Drilling and production testing of two vertical wells	2003
◆ Drilling and production testing of eight horizontal wells	2003/2005
◆ Design, procurement and installation of production and water handling facilities; drilling of two water disposal wells or conversion of two existing wells into water disposal wells	2002/2005
◆ Establishment of Iranian office and field laboratory facilities	2002/2005

It is assumed that a re-completed well would produce 500-1,000 bopd, a vertical well would add 500-1,500 bopd and that a horizontal well could add 2,500 bopd of production.

Upon completion of this development program, incremental production would commence in January 2006. Our target production rate is 20,000 barrels of oil per day and the existing NIOC production will not be part of the Service Contract. At 20,000 bopd, Sheer Energy (Cyprus) and NESCO will receive a remuneration fee equivalent to a compounded 15% rate of return. Additionally, Sheer and NESCO would receive remuneration equivalent to a maximum 17.5% compounded rate of return if production reaches approximately 21,300 bopd. The Company is confident that this upper level can be attained, given the high productivity of Asmari wells and the proposed installation of high lift pumps and water handling facilities.

Engineering estimates indicate that 22 million barrels of incremental production can be recovered during the first 3 years after the completion of the proposed development program.

Total capital and non-capital expenditures for the proposed re-development are forecasted at approximately U.S. \$88 million on a 100% basis. Sheer Energy (Cyprus)'s share of the program will be 49%, or U.S. \$34.4 million for capital expenditures and U.S. \$8.6 million for non-capital expenditures



Canadian Operations Review

The Company's net average daily production for 2001, expressed in barrels of oil equivalent per day (BOE/d) remained fairly constant at 79 BOE/d versus 80.5 BOE/d in the previous year.

Shareholders are reminded that the daily production, expressed in boe/d, is based on a conversion factor of 6 Mcf equaling one barrel of oil. This conversion factor, now widely used in the industry, was adopted by Sheer in 2001 and therefore comparative daily production rates and cumulative production for the year 2000 have been re-stated in this report.

An evaluation of the remaining recoverable reserves and the net present value attributable to six of Sheer's unitized properties was again completed by Fekete Associates Inc. at December 31, 2001. A preliminary independent evaluation of the properties acquired from Krystal Energy Limited was received from Matsalla Consulting (1981) Ltd. This latter report evaluates the proven producing reserves assigned to approximately 250 gas and oil wells operated by Signalta Resources in which Sheer has small working interests.

Fekete Associates Inc. has assigned a 12% net discounted present value of \$1,578,200 to the proven plus probable reserves (probable risked at 50%) at December 31, 2001 versus a value of \$1,942,200 at December 31, 2000.

Remaining recoverable reserves, net to Sheer after royalties, amount to 635,000 Mcf of natural gas and 47,400 barrels of oil and natural gas liquids. This compares favourably to reserves of 734,000 Mcf of natural gas and 46,000 barrels of oil and natural gas liquids reported in the previous year.

Preliminary appraisal by Matsalla Consulting indicates that the remaining recoverable reserves, net after royalties, for the Krystal properties are in the order of 361,250 Mcf of natural gas and 3,658 barrels of oil and natural gas liquids, having an estimated net present value of approximately \$551,250 at a 12% discount rate.

Total remaining recoverable reserves from all of Sheer's properties would therefore be approximately 996,250 Mcf of natural gas and 51,060 barrels of oil and natural gas liquids, with a combined net present value at a 12% discount of approximately \$2,129,450. This is equivalent to total remaining recoverable reserves of 217,100 BOE at December 31, 2001, after production of 28,864 BOE during the year.

The following table summarizes the net present value and the remaining recoverable reserves, net after royalties, of all the combined Canadian properties owned by Sheer.

CALCULATED NET PRESENT VALUE

@ 0%	\$ 3,866,106
@ 10%	\$ 2,302,633
@ 12%	\$ 2,129,450
@ 15%	\$ 1,912,995
@ 18%	\$ 1,737,271

REMAINING RESERVES

Gas (Mcf)	996,252
Oil (bbls)	33,026
NGL (bbls)	18,032

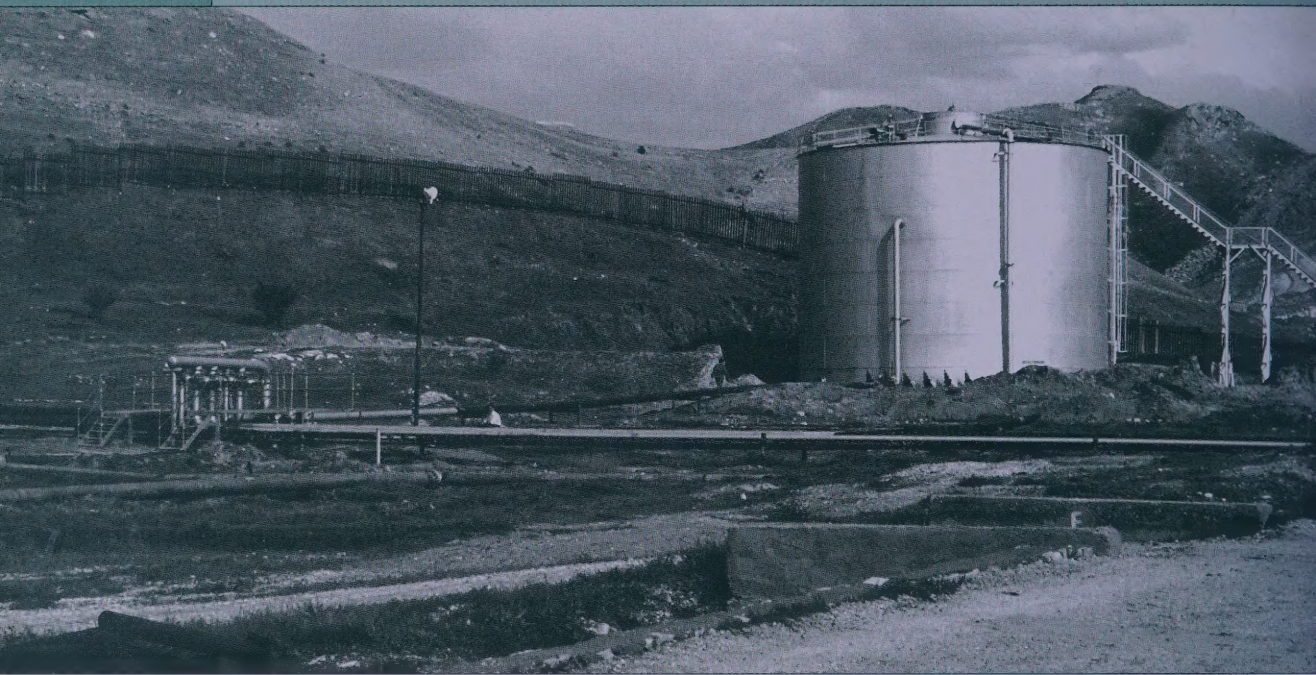
Following is a brief description of the units evaluated by Fekete Associates Inc.

SOUTH EDSON GAS UNIT NO. 1

Sheer has a 8.9688% working interest in the South Edson Gas Unit No. 1 located west of Edmonton. The Unit covers 45,120 gross acres of land and produces gas from the Elkton-Shunda formations at an average gross rate of approximately 2,360 Mcf/day. Three wells are currently on production and five wells are shut-in or suspended, including the 10-33-49-16 W5M well which was reactivated in late 2000 at an average production rate of 1,000 Mcf/day but was later shut-in because of water loading problems. Probable additional reserves were assigned to a proposed drilling location at 11-26-50-17 W5M.

Proved producing reserves, net to Sheer after royalties, amount to 355,000 Mcf of natural gas and 7,000 barrels of natural gas liquids. Net probable additional reserves are 222,000 Mcf of natural gas and 5,000 barrels of natural gas liquids.

The 12% discounted cash flow value assigned to proved producing reserves is \$824,760 and the probable, unrisks reserves would add another \$314,470 to the value of the property.



HARMATTAN EAST UNIT NO. 1

The Company holds a 1.014525% working interest in oil production and a 0.13331% working interest in natural gas production from the Harmattan East No. 1 Petroleum Unit and a 0.13331% working interest in the natural gas production from the Harmattan East No. 1 Natural Gas Unit.

The Petroleum Unit commenced production in 1961 and currently consists of 22 producing wells, 14 water injectors and one CO₂ injector. The Natural Gas Unit has 22 producing wells and three gas storage wells. Remaining recoverable reserves, net to Sheer after royalties, amount to 43,000 Mcf of natural gas and 18,000 barrels of oil and natural gas liquids. The 12% discounted cash flow assigned to the proved producing reserves is \$401,970.

MINOR PROPERTIES

Sheer holds minor working interests in three other oil units, namely Cynthia Cardium Unit No. 4, Snipe Lake Beaverhill Lake Unit No. 1 and Wainright Unit No. 6. The Company's working interest in these three units ranges from 0.076% (Snipe Lake and Wainright) to 0.32% (Cynthia).

Combined 12% discounted cash flow value for proved producing reserves, net to Sheer, is approximately \$47,000.

The Pine Creek Second White Specks "A" Pool Unit, in which the Company had a 5.7612% working interest, was sold on January 1, 2002 for \$165,000. The 12% discounted cash flow assigned by Fekete Associates to this property on December 31, 2001 was \$147,010.

Management's Discussion & Analysis

PRODUCTION VOLUMES AND REVENUES

Production volumes are based on the daily production which resulted in revenues to the account of Sheer Energy Inc. The total net production to the account of the Company in 2001 was 28,864 BOE (based on the conversion of 6 Mcf equalling one barrel of liquid). Total net production for the 2000 fiscal year was 29,390 BOE.

12 months ended December 31,	2001		2000	
	\$	\$/BOE	\$	\$/BOE
Oil and gas revenue	1,042,812	36.13	1,004,073	34.16
Royalties net of ARTC	(283,659)	(9.83)	(219,372)	(7.46)
Interest	3,091	0.11	4,005	0.14
Total net revenue	762,244	26.41	788,706	26.84
Amortization	159,558	5.53	174,837	5.95
Operating costs	156,219	5.41	128,841	4.38
General & administration	237,737	8.24	145,053	4.94
Interest	34,204	1.19	20,884	0.71
Income taxes	75,589	2.62	146,979	5.00
Future site restoration	18,000	0.62	6,000	0.21
Net earnings	80,937	2.80	166,112	5.65

Revenue per barrel of oil equivalent (BOE) was up approximately 6% from the previous year but was distributed unevenly with very high prices early in the fiscal year and considerably lower prices through the balance of the year. Total revenues and production volumes were relatively constant in the comparable periods.

Royalties net of ARTC increased 32% from \$7.46 in the 2000 year to \$9.83 in the 2001 fiscal year primarily as a result of the recognition of a full year of production from the Harmattan East Unit which is ARTC ineligible.

Operating costs increased by 24% from \$4.38 per BOE to \$5.41 per BOE in 2001 due again primarily to the recognition of Harmattan East Unit costs over the full 12 month period.

General and Administrative costs increased by 67% from \$4.94 per BOE in 2000 to \$8.24 in 2001 due primarily to higher consulting fees paid to companies controlled by two of the Directors and full time officers of the Company.

Interest expenses increased 68% from \$0.71 per BOE in 2000 to \$1.19 per BOE in 2001 due to the additional debt incurred to purchase the Harmattan East Unit interests and the mortgage placed on the company's owned office premises.

Income taxes per BOE were reduced by 48% from \$5.00 per BOE to \$2.62 per BOE due to lower earnings in the 2001 fiscal year.

Net earnings were reduced to \$2.80 per BOE in 2001 from \$5.65 per BOE in 2000, a 50% reduction, primarily due to increased royalties, operating costs and general and administrative expenses which were partially offset by reduced income taxes.

Management's Report

To the Shareholders of Sheer Energy Inc.:

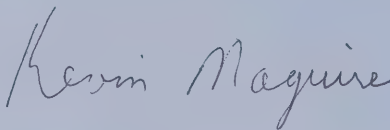
Management is responsible for the preparation of the Financial Statements in accordance with generally accepted accounting principles in Canada. The financial and operating information presented elsewhere in this annual report is consistent with that shown in the financial statements.

Management maintains systems of internal controls to provide reasonable assurance that assets are safeguarded and that relevant and reliable financial information is produced in a timely manner.

Hudson & Company LLP, an independent firm of Chartered Accountants, has been engaged to examine the financial statements. Their report is presented with the financial statements. The Audit Committee of the Board of Directors has reviewed the financial statements with management and the external auditors. The Board of Directors has approved the financial statements on the recommendation of the Audit Committee.



Terrance D. Lawrence
President



Kevin Maguire
Treasurer

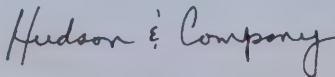
Auditors' Report

To the Shareholders of Sheer Energy Inc.:

We have audited the consolidated balance sheets of Sheer Energy Inc. as at December 31, 2001 and 2000 and the consolidated statements of operations and deficit and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2001 and 2000 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



Calgary, Alberta
March 21, 2002

HUDSON & COMPANY LLP
Chartered Accountants

Consolidated Balance Sheets

DECEMBER 31	2001	2000
ASSETS		
CURRENT		
Cash	\$ -	\$ 3,278
Accounts receivable	79,885	296,609
Prepaid expenses	18,185	19,137
Income taxes receivable	2,364	-
	100,434	319,024
CAPITAL ASSETS (Note 2)	1,585,160	1,394,830
	\$ 1,685,594	\$ 1,713,854

LIABILITIES

CURRENT		
Bank indebtedness (Note 4)	\$ 155,055	\$ -
Accounts payable (Note 3)	101,560	106,755
Income taxes payable	-	64,816
Current portion of long term debt	171,888	283,701
	428,503	455,272
LONG TERM DEBT (Note 5)	207,527	303,741
FUTURE INCOME TAXES	189,065	192,865
FUTURE SITE RESTORATION COSTS	54,858	37,273
	879,953	989,151

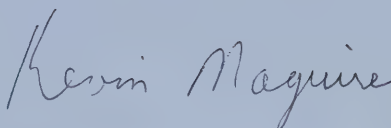
SHAREHOLDERS' EQUITY

SHARE CAPITAL (Note 6)	856,711	856,711
DEFICIT	(51,070)	(132,008)
	805,641	724,703
	\$ 1,685,594	\$ 1,713,854

APPROVED ON BEHALF OF THE BOARD:



Director



Director

Consolidated Statements of Operations and Deficit

YEARS ENDED DECEMBER 31	2001	2000
REVENUES		
Petroleum and natural gas sales	\$ 1,042,812	\$ 1,004,073
Royalties, net of Alberta Royalty Tax Credit	(283,659)	(219,372)
Interest	3,091	4,005
	762,244	788,706
EXPENSES		
Amortization and depletion	159,558	174,837
General and administration (Note 3)	237,737	145,053
Operating costs	156,219	128,841
Interest	34,204	20,884
Provision for site restoration	18,000	6,000
	605,718	475,615
Earnings before income taxes	156,526	313,091
INCOME TAXES (Note 8)		
Current	79,389	140,879
Future (benefit)	(3,800)	6,100
	75,589	146,979
NET EARNINGS	80,937	166,112
DEFICIT, beginning of year	(132,007)	(298,120)
DEFICIT, end of year	\$ (51,070)	\$ (132,008)
Earnings per share (Note 7)		
- Basic and fully diluted	\$ 0.02	\$ 0.03

Consolidated Statements of Cash Flows

YEARS ENDED DECEMBER 31	2001	2000
CASH FLOWS FROM OPERATING ACTIVITIES		
Net earnings	\$ 80,937	\$ 166,112
Items not affecting cash		
Amortization and depletion	159,558	174,837
Future income taxes (recovery)	(3,800)	6,100
Site restoration	18,000	6,000
Cash flows from operations	254,695	353,049
Net change in non-cash working capital balances (Note 9)	145,301	(145,260)
	399,996	207,789
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of capital assets	(350,302)	(628,839)
Proceeds from disposal of capital assets	-	226,200
Cash flows (used in) investing activities	(350,302)	(402,639)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from long term debt	100,000	455,625
Repayment of long term debt	(308,027)	(137,640)
Cash flows from (used in) financing activities	(208,027)	317,985
INCREASE (DECREASE) IN CASH	(158,333)	123,135
CASH (BANK INDEBTEDNESS), beginning of year	3,278	(119,857)
CASH (BANK INDEBTEDNESS), end of year	\$ (155,055)	\$ 3,278
Cash flows from operations per share (Note 7)		
- Basic and fully diluted	\$ 0.05	\$ 0.07

Notes to the Consolidated Financial Statements

DECEMBER 31, 2001 AND 2000

GENERAL

Sheer Energy Inc. was formed at the close of business on December 31, 1998 pursuant to an amalgamation agreement between Sheer Energy Inc. and its wholly owned subsidiary, Krystal Energy Limited.

1. SIGNIFICANT ACCOUNTING POLICIES

Basis of Consolidation

The consolidated financial statements include the accounts of Sheer Energy Inc. and its wholly owned subsidiary Sheer Energy (Cyprus) Limited. The subsidiary was incorporated as a limited liability company in the Republic of Cyprus on July 27, 2000. Significant intercompany accounts and transactions have been eliminated.

Cash and Equivalents

Cash and equivalents consist of funds on deposit in foreign banks and the balance of a demand revolving operating loan available by way of account overdraft.

Capital Assets

The Company follows the full cost method of accounting for oil and gas operations, whereby all costs of exploring for and developing oil and gas properties and related reserves are capitalized. Such costs include land acquisition costs, cost of drilling both productive and non-productive wells, and geological and geophysical expenses and related overhead.

Capitalized costs, excluding costs relating to unproven properties, are depleted using the unit-of-production method based on estimated proven reserves of oil and gas before royalties as determined by independent petroleum engineers. For purposes of the depletion calculation, natural gas reserves and production are converted to equivalent volumes of crude oil based on relative energy content. The foreign cost centre is considered to be in the preproduction stage and accordingly all capitalized costs have been excluded from the depletion calculation.

The Company applies a "ceiling test" to capitalized costs in its two cost centres (foreign and domestic) to ensure that the net costs capitalized do not exceed the estimated future net revenues from the production of its proven reserves, plus the cost of undeveloped lands, less impairment. Future net revenues are calculated at year end prices and include an allowance for estimated future general and administrative expenses, interest expense, income taxes, and capital expenditures.

Gains or losses on the disposition of oil and gas properties are not ordinarily recognized except under circumstances which result in a change in the depletion rate of 20% or more.

Amortization of furniture and office equipment is provided using the declining balance method at an annual rate of 20%.

Amortization of the office condominium is provided using the declining balance method at an annual rate of 4%.

Interest In Joint Ventures

Substantially all of the Company's oil and gas exploration and development activities are conducted jointly with others and, accordingly, the financial statements reflect only the Company's proportionate interest in such activities.

Translation of Foreign Currencies

The accounts of the foreign subsidiary were translated to Canadian dollars using the current-rate method. Under this method, assets and liabilities are translated at the exchange rate in effect at the year end and revenues and expenses at the average rate for the year. Exchange gains or losses on translation were expensed in the current year.

Future Site Restoration and Abandonment Costs

Site restoration and abandonment costs are provided for over the life of the estimated proven reserves on a unit-of-production basis. Costs are estimated each year by management in consultation with the Company's engineers based on current regulations, costs, technology and industry standards. The period charge is expensed and actual site restoration and abandonment expenditures are charged to the accumulated provision account as incurred.

Income Taxes

The Company follows the asset and liability method for accounting for income taxes. Under the asset and liability method, the change in the future tax asset and liability is to be included in income. Future tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled.

The balance of future income taxes at December 31, 2001 consists mainly of the net book value of capital assets in excess of the undepreciated capital cost and unused resource deductions, which arise from the difference between the Company's amortization and depletion rates and those prescribed for income tax purposes, and the future site restoration costs that have been expensed for accounting purposes but are only deductible for tax purposes in the year incurred.

Measurement Uncertainty

The amounts recorded for depletion, and amortization of petroleum and natural gas properties and equipment and the provision for future site restoration and abandonment costs are based on estimates. The ceiling test is based on estimates of proved reserves, production rates, oil and gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

Earnings Per Share

Earnings per share is calculated using the weighted average number of shares outstanding during the year. On January 1, 2001, the Company adopted the treasury method of calculating fully diluted earnings per share as outlined in Section 3500 of the Handbook of the Canadian Institute of Chartered Accountants. This policy has been adopted retroactively and there was no change to the fully diluted earnings per share amount of the previous year.

Stock-based Compensation Plans

The Company has stock option plans, which are described in Note 6. No compensation expense is recognized for these plans when the options are issued. Any consideration received on exercise of the stock options is credited to share capital.

2. CAPITAL ASSETS

	2001		
	Cost	Accumulated Amortization	Net Book Value
Petroleum and natural gas properties and equipment			
Producing	\$ 1,585,702	\$ 602,963	\$ 982,739
Non-producing	390,780	–	390,780
Office furniture and fixtures	23,825	4,791	19,034
Office condominium	196,538	3,931	192,607
	\$ 2,196,845	\$ 611,685	\$ 1,585,160

	2000		
	Cost	Accumulated Amortization	Net Book Value
Petroleum and natural gas properties and equipment			
Producing	\$ 1,534,346	\$ 449,933	\$ 1,084,413
Non-producing	306,079	–	306,079
Office furniture and fixtures	6,532	2,194	4,338
	\$ 1,846,957	\$ 452,127	\$ 1,394,830

3. RELATED PARTY TRANSACTIONS

Consulting Fees

Included in general and administrative expense are consulting fees of \$110,000 (2000 – \$60,000) paid to companies controlled by officers and directors of the Company. Accounts payable and accrued liabilities includes \$29,425 (2000 – \$Nil) payable to these companies for consulting fees. The fees were paid in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

4. BANK INDEBTEDNESS

The bank credit facility allows for a \$150,000 operating line available by way of account overdraft to assist with the acquisition and development of oil and gas reserves. The operating line bears interest at the bank's prime rate plus 1% and is secured as disclosed in Note 5.

5. LONG TERM DEBT

	2001	2000
Office condo mortgage, repayable in monthly payments of \$1,667 plus interest at prime plus 1%, due May 31, 2006.	\$ 88,331	\$ –
Production loan, repayable in monthly payments of \$12,657 plus interest at prime plus 1%, due November 30, 2003.	291,084	455,625
Production loan, repayable in monthly payments of \$4,225 plus interest at prime plus 1%, due October 31, 2001.	–	40,150
Production loan, repayable in monthly payments of \$8,333 plus interest at prime plus 1%, due October 31, 2001.	–	91,667
	379,415	587,442
Less current portion	171,888	283,701
	\$ 207,527	\$ 303,741

Principal repayments due as follows:

2002	\$ 171,888
2003	159,204
2004	20,004
2005	20,004
2006	8,315
	<u>\$ 379,415</u>

Collateral lodged by the Company to support the bank credit facilities are as follows:

- (i) a debenture and general security agreement providing fixed and floating charges over all assets;
- (ii) an assignment of all risk insurance proceeds;
- (iii) environmental indemnity.

6. SHARE CAPITAL

Authorized

Unlimited number of common voting shares

Unlimited number of first preferred non-voting shares

Issued

	2001		2000	
	Number of Shares	Amount	Number of Shares	Amount
Balance at beginning and end of year	4,837,863	\$ 856,711	4,837,863	\$ 856,711

A summary of the Company's director, officer and key employee share options at December 31, 2001 and 2000 and the changes for the years ending on those dates is presented below:

	2001		2000	
	Options Outstanding	Weighted Average Exercise Price	Options Outstanding	Weighted Average Exercise Price
Balance at beginning of year	350,000	\$ 0.20	350,000	\$ 0.20
Granted	100,000	0.25	-	-
Expired	-	-	-	-
Exercised	-	-	-	-
Balance at end of year	450,000	\$ 0.21	350,000	\$ 0.20

The following table summarizes information about the options outstanding at December 31, 2001.

Options Outstanding	Exercise Price	Options Exercisable at December 31, 2001	Expiry Date
350,000	\$ 0.20	350,000	May 1, 2002
100,000	\$ 0.25	100,000	March 15, 2006

7. PER SHARE INFORMATION

Basic earnings and cash flows per share amounts are calculated using the weighted average number of shares outstanding during the period. Diluted earnings and cash flows per share amounts are calculated to reflect the dilutive exercise of outstanding share options.

	2001			2000		
	Net Income	Shares	Per share Amount	Net Income	Shares	Per share Amount
Basic earnings per share	\$ 80,937	4,837,863	\$ 0.02	\$ 166,112	4,837,863	\$ 0.03
Dilutive effect of options	-	16,667	-	-	31,818	-
Diluted earnings per share	\$ 80,937	4,854,530	\$ 0.02	\$ 166,112	4,869,681	\$ 0.03

Options to purchase 100,000 common shares at \$0.25 per share (2000 – Nil) were not included in the computation of diluted earnings and cash flows per share because the option exercise price was greater than the average market price of the common shares.

8. INCOME TAXES

The income tax provision reflects an effective tax rate that differs from the expected tax rate as summarized below:

The provision for income taxes differs from the Canadian statutory rate as follows:

	2001	2000
Earnings before income taxes	\$ 156,526	\$ 313,091
Corporate income tax rate	42.11%	43.62%
Expected income tax expense	65,913	136,570
Increase (decrease) resulting from:		
Non-deductible crown charge and other payments	108,314	96,916
Federal resource allowance	(64,863)	(76,217)
Alberta Royalty Tax Credit	(5,378)	(3,761)
Change in income tax rates	(16,621)	(4,609)
Other	(11,776)	(1,920)
	\$ 75,589	\$ 146,979
Effective income tax rate	48.29%	46.94%

The components of the Company's future income tax liability (asset) are as follows:

	2001	2000
Capital assets	\$ 217,091	\$ 232,225
Share issue costs	(4,938)	(23,028)
Site restoration	(23,101)	(16,258)
Other	13	(74)
	\$ 189,065	\$ 192,865

At December 31, 2001 the Company had the following estimated balances available to apply against future years' taxable income:

Undepreciated capital cost	\$ 304,953
Canadian oil and gas property expense	\$ 434,551
Canadian development expense	\$ 22,621
Foreign exploration and development expenses	\$ 307,501

9. STATEMENTS OF CASH FLOWS

Net Change In Non Cash Working Capital Balances

	2001	2000
(Increase) decrease in accounts receivable	\$ 216,724	\$ (190,552)
Decrease in prepaid expenses	952	3,337
Decrease in accounts payable	(5,195)	(9,161)
Increase (decrease) in income taxes payable	(67,180)	51,116
	\$ 145,301	\$ (145,260)

Interest and Income Taxes Paid

During the year the Company had cash flows arising from interest and income taxes paid as follows:

	2001	2000
Interest paid	\$ 39,558	\$ 15,530
Income taxes paid	\$ 151,910	\$ 87,990

10. FINANCIAL INSTRUMENTS

Credit Risk

Credit risk arises from the possibility that the entities to which the Company sells its oil and gas production to may experience difficulty and be unable to fulfill their obligations. The Company is exposed to financial risk that arises from the credit quality of the entities to which it provides services. However, due to the credit quality of the entities to which the Company sells to, credit risk and credit risk concentration is minimized.

Interest Rate Risk

Interest rate risk arises from the possibility that the value of, or cash flows related to, a financial instrument will fluctuate as a result of changes in market interest rates. The Company is exposed to financial risk that arises from the interest rate differentials between the market interest rate and the rates used on their financial instruments.

The bank indebtedness and long term debt bear a variable interest rate of prime plus 1%. The effective interest rate realized during the year was 5.7% (2000 – 5.3%). The average interest rate was 6.8% (2000 – 7.3%).

Fair Values

The fair values for cash, accounts receivable and accounts payable approximates their carrying values due to the short term maturity of those instruments.

The carrying values for bank credit facility and future site restoration costs approximated the fair values.

Foreign Exchange Rate Fluctuation

The Company is exposed to foreign currency fluctuation in relation to its wholly owned subsidiary Sheer Energy (Cyprus) Limited. Management believes this exposure is not material to its overall operations.

11. SEGMENTED INFORMATION

The Company's business activities are undertaken in Canada and the Middle East. The accounting policies followed by the Canadian segment are also followed by the Middle East segment.

2001	Canada	Middle East	Total
Corporate revenue	\$ 1,042,812	\$ -	\$ 1,042,812
Corporate expense	879,287	6,999	886,286
Income (loss) from operations	\$ 163,525	\$ (6,999)	\$ 156,526
Identifiable assets	\$ 1,068,413	\$ 405,540	\$ 1,473,953
Corporate assets	211,641	-	211,641
Total assets	\$ 1,280,054	\$ 405,540	\$ 1,685,594
2000	Canada	Middle East	Total
Corporate revenue	\$ 1,004,073	\$ -	\$ 1,004,073
Corporate expense	681,405	9,577	690,982
Income (loss) from operations	\$ 322,668	\$ (9,577)	\$ 313,091
Identifiable assets	\$ 1,397,232	\$ 312,284	\$ 1,709,516
Corporate assets	4,338	-	4,338
Total assets	\$ 1,401,570	\$ 312,284	\$ 1,713,854

12. SUBSEQUENT EVENT**Iran Service Contract**

On March 13, 2001 the Company announced that it had reached an agreement on a service contract for the Masjed-I-Suleyman (MIS) oil field in Iran. All necessary government approvals on the service contract terms and conditions were received February 12, 2002. Sheer Energy (Cyprus) Limited is the operator of the project and holds a 49% interest. The terms of the agreement call for total expenditures relating to the project of US\$88 million by Sheer Energy (Cyprus) Limited and its partner Naftgaran Engineering Services Company of Tehran (51%) over a period of four years commencing immediately. Repayment will be made from crude oil sales over three years following the project completion.

13. COMPARATIVE FIGURES

Certain prior years' balance sheet figures were reclassified to reflect the future-tax effect of share issuance costs in accordance with Section 3465 of the Canadian Institute of Chartered Accountants Handbook. Specifically, the future tax liability was decreased and the share capital increased by \$23,000.

Corporate Information

OFFICERS AND DIRECTORS

Terrance D. Lawrence
President and Director

Dario E. Sodero
Vice President and Director

Kevin M. Maguire
Treasurer and Director

Charles S. Cook
Director

Julio Poscente
Director

William C. Ranson
Secretary

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STOCK EXCHANGE LISTING

TSX Venture Exchange
Symbol: "SHU"

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An aerial photograph of a rugged, mountainous landscape. The terrain is characterized by steep, eroded slopes with a mix of green vegetation and exposed brown and reddish soil. The mountains are layered, with some peaks in the distance appearing more blueish-grey. The sky is a clear, pale blue.

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